

Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03

INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02

CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

CEA-01 AGR-05 /083 W

----- 033261

R 181010Z AUG 76

FM AMEMBASSY JIDDA

TO SECSTATE WASHDC 5635

AMCONSUL DHAHRAN

C O N F I D E N T I A L JIDDA 5690

E.O. 11652: GDS

TAGS: ECON, SA

SUBJECT: INFLATION IN SAUDI ARABIA

EMBASSY TRANSMITS FOLLOWING RECEIVED FROM GNEHM IN RIYADH:

1. SUMMARY: CONSULTANTS WITH SAUDI MINISTRY OF PLANNING HAVE COMPLETED STUDY OF RISING COSTS AND INFLATION IN SAUDI ARABIA. THE REPORT (NOT YET RELEASED) CONCLUDES THAT SAUDI ARABIA WAS IMPORTING SOME INFLATION FROM ABROAD IN 1974 AND THE SEVERAL YEARS PRECEDING THAT BUT THAT THE INFLATION WHICH HIT THE COUNTRY IN 1975 AND 1976 IS PRIMARILY DOMESTICALLY GENERATED.

2. STUDY COMPARED RETAIL (SHELF) PRICE IN SAUDI ARABIA OF 100 NON PERISHABLE FOOD ITEMS. IN SIX MONTH PERIOD FROM SEPTEMBER/OCTOBER 1975 TO MARCH 1976, RETAIL PRICES FOR EXACT 100 ITEMS (BY BRANDS, QUANTITIES, AND PACKAGING) ROSE 28 PERCENT OR AT AN ANNUAL RATE OF 56 PERCENT. DURING SAME SIX MONTH PERIOD, EXPORT INDEX OF PRICES FOR SAME 100 ITEMS LEAVING THE U.S. ROSE ONLY ONE AND A HALF PERCENT. FREIGHT CHARGES AND PORT CONGESTION SURCHARGE REMAINED UNCHANGED. THUS RISE OF 28 PERCENT IS ALMOST COMPLETELY RESULT OF HIGHER PROFIT TAKING BY SAUDI IMPORTERS, FREIGHT HANDLERS, AND RETAILERS.

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3. STUDY CONCLUDES THAT CURRENT LEVELS OF PROFIT TAKING ARE UNACCEPTABLY HIGH. RETAIL SHELF PRICE OF 100 FOOD ITEMS IN SAUDI ARABIA (SAME ITEMS AS ABOVE) IS 65 PERCENT HIGHER THAN PRICE OF SAME 100 ITEMS IN U.S. RETAIL GROCERY. (U.S. PRICE IS FIGURED ON AVERAGE COST OF ITEMS IN RETAIL OUTLETS IN WASHINGTON, D.C. AND SAN FRANCISCO.) STUDY CALCULATES THAT 20 PERCENT OF DIFFERENCE BETWEEN U.S. AND SAUDI PRICES IS DUE TO TRANSPORTATION COSTS BETWEEN U.S. AND SAUDI ARABIA (15 PERCENT OF COST OF FOOD ITEMS) AND THE PORT CONGESTION SURCHARGE (5 PERCENT OF COST). (NOTE: CONSULTANT BELIEVES THAT 5 PERCENT PORT SURCHARGE IS HIGH). REMAINING 40 PERCENT TO 45 PERCENT IN PRICE DIFFERENCE IS MEASURE OF CURRENT PROFIT TAKING BY SAUDI BUSINESSMEN. EVEN THIS ESTIMATE IS LOW AS SAUDI IMPORTERS ARE PAYING WHOLESALE NOT RETAIL PRICES FOR FOOD ITEMS PURCHASED IN U.S.

4. REPORT RECOMMENDS SAG CONCLUDE AGREEMENT WITH LARGE AMERICAN FOOD CHAIN TO IMPORT AND MARKET FOOD ITEMS AT FAIR MARKET PRICE. U.S. FOOD CHAIN WOULD OPERATE ON STRAIGHT FEE AND NOT FOR PROFITS ON FOOD SALES. PRICES FOR FOOD ITEMS WOULD BE AT COST PLUS FIXED PERCENTAGE FOR OVERHEAD. STUDY SAYS INTRODUCTION OF SUCH A FOOD CHAIN WOULD NOT PUT SAUDI RETAILERS OUT OF BUSINESS BUT WOULD FORCE THESE RETAILERS TO SETTLE FOR LOWER PROFIT MARGINS.

5. INITIAL SAG REACTIONS TO RECOMMENDATION TO USE OF AMERICAN FOOD CHAIN WAS NEGATIVE. SAUDI COUNTERPARTS TO AMERICAN CONSULTANTS ARE RECOMMENDING THAT SAG CONTRACT WITH PRIVATE SAUDI BUSINESSMAN TO IMPORT FOOD ON COST PLUS FIXED FEE BASIS AND THAT SAG THEN ESTABLISH WAREHOUSES THROUGHOUT THE KINGDOM TO DISTRIBUTE THESE FOOD ITEMS TO RETAILERS. THERE IS NO REFERENCE UNDER THIS PLAN TO CONTROL RETAIL PRICES, BUT SAG HAS DECIDED INFORMALLY THAT 10 PERCENT AND 12 PERCENT MARK-UPS ARE FAIR PROFITS FOR IMPORTERS AND RETAILERS RESPECTIVELY. SAG IS REPORTEDLY WILLING TO PROVIDE CAPITAL OF \$500 MILLION FOR FOOD IMPORTS UNDER THIS PROGRAM AND IS WILLING INCREASE THIS AMOUNT IF PROGRAM IS SUCCESSFUL.

6. STUDY ALSO EXAMINED INCREASE IN COST OF HOUSING AND RENTALS IN TWENTY LARGEST CITIES IN SAUDI ARABIA. IN PERIOD SINCE JANUARY 1975 STUDY REVEALED THAT RENTS ON BOTH HOUSES AND APARTMENTS HAD JUMPED A WHOPPING 600 PERCENT. THIS FIGURE BASED ON HIGHER COSTS
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PAID FOR HOUSING BY SEVERAL SAUDI (NOT FOREIGN) CORPORATIONS INCLUDING SAUDIA AIRLINES. IN SEPARATE BUT RELATED STUDY GROUP FOUND THAT RENTS FOR LOW INCOME URBAN HOUSING (HOUSES WITH NO RUNNING WATER OR REGULAR ELECTRICITY) HAVE RISEN 50 PERCENT IN PAST YEAR. STUDY STRESSES SEVERE PRESSURE SUCH INCREASE PLACES ON LOW INCOME CLASS AND URGES SAG TO TAKE ACTION TO STOP RENT SPIRAL. SAG REACTION HAS BEEN TO CONSIDER FORMATION OF A REALTY BOARD

WITH LIMITED CAPITAL (ABOUT \$300 MILLION) TO ENCOURAGE CONSTRUCTION OF MORE LOW INCOME URBAN HOUSING. AS WITH FOOD PRICES, REPORT POINTS OUT THAT INFLATIONARY RENT INCREASES ARE RESULT OF DOMESTIC FACTORS AND NOT TO RISING COSTS OF IMPORTS.

7. CONCLUSION: AIM OF REPORT WAS TO CONVINCE SAG THAT RAMPANT INFLATION NOW GOING ON IN KINGDOM IS ALMOST TOTALLY DUE TO DOMESTIC FACTORS AND NOT TO RISING PRICES ABROAD. REPORTEDLY MINISTRY OF PLANNING, AT LEAST, IS CONVINCED. REPORT MADE SPECIFIC SUGGESTIONS FOR DEALING WITH BOTH PROBLEMS OF FOOD COSTS AND RENT INCREASES, BUT SAG REACTION IN BOTH CASES WAS LUKEWARM. THIS REACTION IS DUE TO FACT THAT SAUDIS WHO MUST INSTITUTE NEW PROGRAMS TO ALLEVIATE PRESENT RATE OF INFLATION ARE VERY SAME PERSONS WHO ARE REAPING THE LARGEST PROFITS NOW. REACTION ALSO SAYS THAT SAUDI OFFICIALDOM DOES NOT YET BELIEVE SQUEEZE ON LOW AND MIDDLE INCOME FAMILIES CRITICAL ENOUGH TO WARRANT CHANGE. PORTER

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC CONDITIONS, INFLATION, RETAIL PRICES
Control Number: n/a
Copy: SINGLE
Draft Date: 18 AUG 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: ShawDG
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976JIDDA05690
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D760316-0997
From: JIDDA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19760843/aaaablev.tel
Line Count: 132
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION NEA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: ShawDG
Review Comment: n/a
Review Content Flags:
Review Date: 22 JUN 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <22 JUN 2004 by GarlanWA>; APPROVED <02 NOV 2004 by ShawDG>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: INFLATION IN SAUDI ARABIA EMBASSY TRANSMITS FOLLOWING RECEIVED FROM GNEHM IN RIYADH
TAGS: ECON, SA
To: STATE DHAHRAN
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006